IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935

No. 610

NORFOLK AND WESTERN RAILROAD COMPANY, Appellant

vs.

STATE OF NORTH CAROLINA on Relation of A. J. MAXWELL, Commissioner of Revenue

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Brief of Appellee

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

OPINION BELOW

The opinion of the Supreme Court of North Carolina in this case is printed in full on page 839 of the record.

JURISDICTION OF THE COURT

Appellee respectfully submits that inasmuch as the cause of the appellant in the court below depended entirely upon the determination of facts and as the trial there was had upon competent evidence in the regular practice and pro-

cedure of the Court and by proceedings entirely consistent with the constitutional requirement of due process of law, and there resulted in a judgment against the appellant upon the evidence in the cause, this Court will not now undertake to review the matter upon appeal from the State Court.

Campau *v.* Lewis, 3 Wall. 106, 18 L. Ed. 211;
Hall *v.* Jordan, 15 Wall. 393, 21 L. Ed. 72;
Clipper Mining Co. *v.* Land Co., 194 U. S. 220, 48 L. Ed. 944;
Smiley *v.* Kansas, 196 U. S. 447, 49 L. Ed. 546;
Waters Pierce Oil Co. *v.* Texas, 212 U. S. 86, 53 L. Ed. 417;
Kentucky Finance Corporation *v.* Paramount Auto Exchange Corp., 262 U. S. 554, 71 L. Ed. 1165.

Appellee further insists that the case does not fall within any of the recognized exceptions to this rule, as all the findings of fact of the court below and the decision of the Court upon the issue involved were fully sustained by the evidence in the cause.

New York *v.* Roberts, 171 U. S. 658, 19 S. Ct. 658;
Great Northern R. R. Co. *v.* Donaldson, 246 U. S. 121, 62 L. Ed. 616;
Miedreich *v.* Lauenstien, 132 U. S. 236, 58 L. Ed. 584;
Southern P. Co. *v.* Schuyler, 227 U. S. 601, 57 L. Ed. 662;
Portland R. Light and P. Co. *v.* R. R. Commission, 229 U. S. 397, 411, 57 L. Ed. 1248.

In this connection, we wish to point out that the burden in the Trial Court rested upon this appellant to prove its contentions by evidence. No evidence whatever offered by the appellant in the court below was either excluded or rejected; but the outstanding feature of the case was that this appellant itself failed to introduce evidence upon which the Court might determine the issue involved in its contention. Not that the appellant failed to introduce any evi-

dence whatever, but that it failed to introduce evidence upon points determinative of the issue. This will be more fully discussed later in this brief in relation to other contentions of the appellant. See p. 18.

Upon the question of jurisdiction, the appellant has narrowed its claim down to the following:

"The appellant's statement of jurisdiction on appeal discloses that the State Courts ignored or overruled the relevant admitted finding of the Referee. In such a case this Court cannot protect duly ascertained Federal rights without considering the fact findings and determining upon its own independent judgment the essential facts." To support this, the brief quotes Crowell *v.* Benson, 285 U. S. 60.

The quotation reveals an entire misunderstanding of the case cited. We do not understand that case, or any other case, to hold that this Court would enter into an independent consideration of the facts except solely for the purpose of finding whether any right under the Federal Constitution has been invaded, and whether the appellant has had a fair opportunity of having the facts determined in a competent trial in a court of proper jurisdiction under proceedings consistent with due process of law, where the case itself rests in the establishment of such facts.

Cincinnati Street R. R. Co. *v.* Snell, 193 U. S. 30, 48 L. Ed. 604;

Lee *v.* Central of Georgia R. R. Co., 252 U. S. 109, 64 L. Ed. 482;

Central Vermont R. R. Co. *v.* White, 238 U. S. 507, 59 L. Ed. 1433;

Power Mfg. Co. *v.* Saunders, 274 U. S. 491, 71 L. Ed. 1165.

This appellant had such full opportunity in the court below, was permitted to avail itself fully of it, and no evidence whatever offered by it was rejected or excluded. R. p. 166 through 382, and 697 through 796.

It is a fact, however, that appellant on the trial below did not see fit to introduce evidence essential to sustain its contention, as hereafter pointed out, and of this it cannot complain of the court below.

We think the cases sustaining the rule that this Court will not enter into a review of a case heard in the court below upon competent evidence, according to the practice and procedure of the Court, fully apply.

Smiley *v.* Kansas, 196 U. S. 447, 49 L. Ed. 546;
Waters Oil Co. *v.* Texas, 212 U. S. 86, 53 L. Ed. 417;
Hedrick *v.* Atchison R. R. Co., 167 U. S. 673, 42 L. Ed. 320;
Ætna Life Ins. Co. *v.* Dunken, 266 U. S. 389, 69 L. Ed. 342.

Further matters bearing upon the jurisdiction of the Court on review will appear below in the argument.

PRINCIPAL QUESTION INVOLVED

In view of the manner in which the case was tried below, and the method by which appellant sought there to maintain its contention, certain questions are outstanding in this case, the decision of which should determine the controversy. It will be helpful if they are understood before a more extended examination of the record is attempted.

The gravamen of this case is the contention of the appellant that the North Carolina State Income Tax Law, as applied to its business, had an unconstitutional result, in that it taxed net income which appellant did not have in the State of North Carolina. The North Carolina Constitution lays income tax only on net income.

Appellant's appeal brings up an adverse finding of the court below upon its contention that the application of the

revenue laws of North Carolina, relating to net income, produced an unconstitutional result when applied to its business.

While challenging the application of the statute to its business as being unconstitutional, on the trial below appellant offered no evidence as to its actual gross income in North Carolina from which net income could be ascertained; *but relied entirely on the fractional part of the allocation statute recited below, to show such gross revenue;* thus rejecting the part of the allocation formula which resulted in the ascertainment of gross operating expenses and which did not suit its purpose, and accepting and relying upon the other part of the formula relating to gross revenues in lieu of proof of such revenue, as the allocation statute itself affords no proof that appellant's actual gross revenues, or gross operating revenues, were not sufficiently greater than the operating expenses to produce the net taxed against appellant. The net income with which we are dealing is the difference between gross operating revenues and gross operating expenses.

The North Carolina statutes under which the net income of the appellant was ascertained and taxed are Public Laws of North Carolina of 1927, Section 312, and Public Laws of North Carolina of 1929, Section 312, identical in language. That portion which is pertinent to this case reads as follows:

> "And when their business is in part within and in part without the State, their net income within this State shall be ascertained by taking their gross operating revenues within the State, including in their gross operating revenues within this State the equal mileage proportion within this State of their interstate business and deducting from their gross operating revenues the proportionate average of operating expenses or operating ratio for their whole business, as shown by the Interstate Commerce Commission Standard Classification of Accounts."

In the proceedings had in the Courts of North Carolina, the appellant did not raise any question as to the constitutionality of this statute on its face. Its constitutionality has been sustained by this Court in Atlantic Coast Line Railroad Co. *v.* Doughton, 262 U. S. 413, 67 L. Ed. 1051.

This section of the North Carolina Revenue Act seeks to tax only the income earned in North Carolina by interstate carriers, and sets out a formula for determining the two basic factors concerned in determining the amount of their taxable net income earned within North Carolina—gross operating revenue and operating expenses. The net is found by subtracting the latter from the former. The appellant contends that the formula understates the operating expenses deductible from gross income to arrive at net taxable income, and upon the trial introduced evidence as to the actual gross expenses. It introduced no evidence as to the gross income, which brings us to the substance of this controversy.

The appellant contends that inasmuch as the statutory formula does not fit this particular case with respect to operating expenses, it is entitled to disregard that part of the formula and introduce evidence concerning actual gross operating expenses; and further contends that it may at the same time invoke that part of the formula relating to its gross revenue, and which, according to the evidence in this case, understates the gross revenue in a greater proportion than it understates the operating expenses.

In other words, while the appellant rests its case on an allegation that the statutory formula violates its constitutional rights, it at the same time claims the benefit of a part of that statutory formula which operates to its advantage.

The contention of the State of North Carolina is that the tax assessed under the formula is entitled to stand, unless it can be shown that the formula, as applied in its entirety to both its gross income and expenses, violates the consti-

tutional rights of the appellant. The State contends that if the statutory formula should be entirely disregarded and both revenue and expenses set up on an actual basis, taxable net income would be substantially greater than that produced by the application of the formula to both revenue and expenses.

In other words, the State contends that if the taxing formula is challenged, that to sustain its case the burden rested upon the Railroad Company to show that the actual operating expenses subtracted from the actual gross revenue left no net income, or substantially less net income than that which was taxed by the State.

Underwood Typewriter Co. *v.* Chamberlain, 254 U. S. 113, 65 L. Ed. 165.

The appellant contends not only that it is competent for it to rely upon the fractional part of the formula as representing gross revenue, but further that the State is estopped from showing the actual revenue to be greater than the averaged revenue produced by application of that portion of the formula.

To have succeeded, therefore, in the court below, since as seen appellant introduced no evidence as to its gross revenue, it was necessary that appellant should successfully maintain both its contentions with reference to the mileage prorate part of the statute relating to allocated gross revenue, relied upon by it in lieu of such evidence:

First: That it might separate and use this part of the formula relating to mileage prorate gross revenue, independently of the rest of the formula relating to operating expenses; and although the parts of the statute are in functional relation with each other, intended only for administrative purposes, producing only an averaged prorate, and although actual net income is the subject of the inquiry.

Second: That the State is estopped from showing that the gross revenue of appellant in North Carolina is greater

than that ascertained by the statutory formula in answer to the claim that the actual expenses are greater than the formula determines.

In both respects the Supreme Court of North Carolina, in interpreting the statute, ruled against appellant. We respectfully submit that this interpretation of the Supreme Court of a statute of its own State within the due process requirement of the Constitution, will be accepted by this Court. If so, the controversy ends here.

Swiss Oil Co. *v.* Shanks, 273 U. S. 407, 71 L. Ed. 709;
Saltonstall *v.* Saltonstall, 276 U. S. 260, 72 L. Ed. 565;
Quong Ham Wah Co. *v.* Ind. Acc. Com. of Col., 255 U. S. 445, 65 L. Ed. 723;
Am. Express Ry. Co. *v.* F. S. Royster Guano Co., 273 U. S. 274, 71 L. Ed. 642;
Appleby *v.* City of New York, 271 U. S. 364, 70 L. Ed. 992;
Supreme Lodge *v.* Mayer, 265 U. S. 30, 68 L. Ed. 885;
Hughes Fed. Practice, Vol. 5, p. 331.

If the interpretation is open to review here, we respectfully submit that this Court must, upon consideration, come to the same conclusion.

STATEMENT OF THE CASE

Under the State revenue law above mentioned, the appellant filed its returns for the years 1927, 1928, and 1929; but in filing this return departed from the statutory method intended to ascertain net income and disregarded the part of the statutory formula relating to expenses of operation, and set up such alleged expenses of operation according to a system and method of its own and proceeded to deduct this from the gross revenues allocated to North Carolina under the mileage prorate part of the formula. It reported no taxable income for these years.

The Commissioner of Revenue reviewed the returns, applied the statute and found a taxable net income for the three years in question and assessed tax thereon in the sum of $86,421.71.

The company filed a protest, and upon the overruling of this protest by the Commissioner, paid the tax and appealed to the Superior Court of Wake County, such appeal being provided in the statute, where the matter was heard under the statutes of North Carolina applicable to the case.

By statutory designation, the State upon the relation of the Commissioner of Revenue, was plaintiff, and the Norfolk and Western Railroad Company was defendant; but the defendant company was really the actor and plaintiff under the burden to establish its contention that the imposition of the tax in its incidence upon it was unconstitutional. There is no controversy about this.

The cause was referred to Hon. J. Crawford Biggs, to take the evidence and make and state his findings of fact and conclusions of law under the North Carolina statutes pertaining to reference cases. See Appendix for this statute.

Upon the hearing before the Referee, evidence was introduced by the defendant company and by the State, which comprises most of the 835 pages of record which the præcipe of the plaintiff in error has required to be certified to this Court.

Upon this hearing (before the Referee), numerous exceptions were taken to the admission of evidence, both on the part of the plaintiff and of the defendant, but later upon review by the Superior Court, the defendant company did not bring to the attention of the trial judge any of these exceptions or insist upon any ruling as to any of them.

Under the North Carolina procedure, he could not do so on appeal.

Wallace *v.* Douglas, 103 N. C. 19, 9 S. E. 453;
McNeill *v.* Hodges, 105 N. C. 52, 11 S. E. 265;
Baker *v.* Edwards, 176 N. C. 229, 97 S. E. 610.

The Referee found against the validity of the tax and made a report stating his findings of fact and conclusions of law, which were adverse to the State. Record p. 73. To this report the Commissioner of Revenue, in apt time, objected and excepted and moved to set aside the same and for a review thereof; R. p. 91.

The defendant company, this appellant, filed no objections or exceptions to the report.

The matter came on for a hearing before Hon. H. A. Grady, Presiding Judge of the Superior Court, at term, and jury trial was there waived and the matter went to the hearing.

C. S. 578 (Michie's North Carolina Code, 1935);
Cummings *v.* Swepson, 124 N. C. 579, 32 S. E. 966;
Wallace *v.* Benner, 200 N. C. 124, 156 S. E. 795;
Thigpen *v.* Farmer's Banking, etc. Co., 203 N. C. 291, 165 S. E. 720.

After hearing the argument, the Presiding Judge set aside the findings of fact and conclusions of law of the Referee and made his own findings of fact and conclusions of law and signed a judgment adverse to the defendant company, which appears in the record on pages 145-152.

The defendant company appealed to the Supreme Court of North Carolina, which reviewed the entire matter upon the exceptions filed, passed upon the procedure of the court below and filed an opinion and rendered the judgment found in the record on page 839.

FACTS INVOLVED

It became advisable to enter somewhat into the evidence presented in the court below under heading III on page 45 of this brief, in response to the arrangement of appellant's brief, and in order to show the fact situation with which the Court dealt on the trial below.

In that reference to the evidence and to the facts which were before the Court, we will say briefly that it deals principally with facts developed on the trial with reference to the superiority of the North Carolina revenue over that of the system generally; with the difference between rates in Official and Southern Territory, in which Southern Territory the North Carolina branch lines concerned in this controversy lie; with citations from the record showing the evidence before the Court as to appellant's gross revenues in this State; with admissions made by the Railway's witnesses that that revenue was richer per ton mile revenue earning in North Carolina in the proportion of 141.7% for North Carolina revenue to 100% system revenue; and with direct testimony showing the fact that North Carolina revenue was sufficiently larger than the mileage prorate result to include more than the statutory net taxed in this State.

Further reference will be found in that analysis to the superior revenue-producing nature of the commodities handled into and out of North Carolina on appellant's road, into the comparatively low rates in force in Official Territory and main line territory, and references by way of explanation to certain Interstate Commerce Commission reports, and cases to which this appellant was a party.

In the interest of space and time, we do not reprint this here, but respectfully refer the Court to the important facts presented on pages 50 et seq. of the brief.

APPELLANT'S SPECIFICATIONS OF ERROR

Specifications of Error I and II, on pages 11 and 12 of the brief, seem to indicate that appellant is now raising some question as to the constitutionality of the North Carolina Income Statute upon its face, or per se. The law could not be held unconstitutional simply because it failed to fit the case of one taxpayer.

At any rate, the constitutionality of the act has been sustained in Atlantic Coast Line Railway Co. *v.* Doughton, 262 U. S. 413, in which case the present appellant was a party.

We therefore assume that the counsel meant to say that the application of the statute to the business of this railway produced an unconstitutional result as applied to its business, as the brief predicates the unconstitutionality of the act on what it is pleased to designate as the fact established by the record relating to the business of appellant.

The Supreme Court of North Carolina could not very well strike down the law which seems to fit every other railroad doing an interstate business partly in North Carolina just because it did not happen to reasonably apply to this railway, if such should be the case. The necessity of proving that the statute does not reasonably ascertain the correct or actual net income upon which the tax is imposed immediately carries the case out of the sphere of condemnation by the court as a matter of law, and into the sphere of trial upon such proof of facts as the railway might see fit to produce in support of its contention.

Appellant's contentions, therefore, largely merge into the further objections, III, page 13, and IV, page 13.

Under Assignment III it is complained that the Supreme Court erred in adopting the findings of fact made by the Judge of the Superior Court of Wake County as the basis of conclusions of law that appellant had not been deprived of

rights guaranteed by the Fourteenth Amendment to the Constitution of the United States, because allegedly those findings were:

(a) Contrary to the admissions of the State in the record, and

(b) Unsupported by evidence.

Assignment IV will be found to be a mere amplification of these two statements.

The Supreme Court of North Carolina is an Appellate Court, of last resort to which appeals may be made only on matters of law. It has no power over any finding of the court below made upon competent evidence. It can not be said to adopt or reject findings of fact. The manner in which it dealt with this case will be dealt with further on. It becomes necessary here, however, to deny as not borne out by the record the statement under "a" that the State made the admissions claimed by appellant, and to which, it will hereafter appear, the brief has reference.

As to "b," this doubtless refers to the evidence of appellant's actual gross operating revenue in North Carolina, tending to show that it was greater than that found by the application of the statutory formula, just as the railway claimed its expenses were greater than the statutory formula discloses. Appellant has consistently maintained that the court had no right to pry into its actual gross revenues in this State; however, larger than or less than that disclosed by the administrative formula. The notion is that if this evidence is disregarded and the administrative formula as to gross operating revenues alone consulted, the finding that its gross revenues were larger than that formula determines would not be supported. It further characterizes the evidence in this regard as "insufficient."

Assignment IV will be found to be a simple amplification of the foregoing.

Many claims are made in appellant's brief that important admissions were made by the State, all of which statements are unwarranted. *No such admissions appear in the record and they were not made.* Appellant's brief is full of these unjustified claims; that this or that fact on which counsel depended has been "admitted," and this or that evidence offered by the railway is "undisputed." We do not know how to deal with a matter of that kind except with that frankness which we think is due the court and which we know is our duty to our client. We here give page citations to appellant's brief containing these statements. They will be found to occur in many other places which we have overlooked. On pages 8, 11, [illegible] and 36, statements of this character are made as to alleged admissions by the State's witness, Roberts, which, of course, are construed into binding admissions by the State; and in one place in the brief erected into an admission upon which appellant bases its principal claim for review by this Court.

These supposed admissions relate to the statement by the witness, Roberts, printed on page 8 of the brief, near the bottom.

Of this statement on the same page appellant's brief comments:

"Before the Referee the State admitted that the operating expenses of the railway's branch lines entering the State are higher *than is indicated by the statutory formula.*"

The extract from witness' testimony is made to stand alone without explanation by his accompanying and succeeding statement.

It will be seen that the witness did not make the admission which is credited to him, nor anything approaching it. His testimony was directly to the contrary. The witness was comparing expenses on the railway branch lines in this State to expenses on the main line of the system and said they were higher. He was not dealing with revenue at all,

with which the system ratio does deal, making a proportion between expenses and revenue. The system ratio was not in any manner at all involved in the statement, and, therefore, the inference drawn by the brief which would make this an admission that "the operating expenses of the railway's branch lines entering the State are higher than is indicated by the statutory formula" is entirely wrong. In fact, immediately after making this statement the witness proceeded to deal with the revenue side of the formula, the revenue side of the system ratio, and his whole testimony tended to show that the formula held true when applied to the railway's North Carolina business.

The State has not denied the cost of operation in North Carolina may be higher than the average cost of operation of the system as a whole, but it has never admitted in any way, through a sole witness, or otherwise, that the fraction representing the system ratio is not completely applicable to the railway's North Carolina business, nor has the railway in any manner disproved its applicability. If the railway's figure for aggregate North Carolina expenses (built up by a fallacious method nevertheless) could be accepted as true, the witness Roberts did not admit that there was anything wrong with the application of the system ratio; he merely compared the North Carolina cost against the system cost—not against North Carolina gross revenues, and proceeded to demonstrate from the railway's records that the greater North Carolina revenue fully justifies the application of the system ratio.

It is to be noted here that this erroneous claim of admissions by the State appellant succeeded in having made the basis for the finding of the Referee, which was set aside by the Judge.

On page 11 of the brief, counsel for appellant construed into an admission on the part of the State that the gross operating revenue of the railway found by application of

mileage prorate formula correctly represents the actual gross revenues of the railway in this State for the cost in question. All that the Commissioner of Revenue stated as to that was that the statute was correctly applied as to the mileage prorate of revenue.

On page 11 of the brief, counsel for appellant narrows the field of investigation of this Court to the following:

"In this Court, as in the courts below, counsel will seek to demonstrate that there was no dispute of fact upon any material issue, that the material findings of the Referee were in fact undisputed, substantially admitted by the State, and the judgment denying recovery is based upon a theory which disregards the State tax statute and surmises the existence of taxable income in some amount not less than the amount the railway company was required to pay. Thus the success of the appellant in this Court is made frankly to depend upon alleged admissions of the State which we as frankly say, do not appear upon the record whenever made. If these so-called admissions are vitally necessary to appellant's case here, certainly it is the duty of counsel for appellee to point out the flimsy ground on which such demands are predicated.

We have done our best to point out the place in the record and the statements to which appellant's brief probably refer. At most, it can be said that appellant's brief has placed obviously erroneous interpretations on these statements and drawn from them inferences of its own which it parades in the brief as admissions of the State.

SUMMARY OF THE ARGUMENT

The appellant has divided its argument into three propositions, which, upon analysis, will be found to contain largely repetitions of the same contentions. It is our purpose,

however, to take these contentions up, as nearly as possible, in the order of argument stated below, with appropriate reference to appellant's brief.

I

APPELLANT'S CASE IN THE COURT BELOW RESTED ENTIRELY ON THE ASCERTAINMENT OF FACTS, AND THE BURDEN WAS UPON APPELLANT. THESE FACTS WERE FOUND ON COMPETENT EVIDENCE AS FAR AS WAS NECESSARY TO FIND THEM, IN ACCORDANCE WITH THE PRACTICE AND PROCEDURE OF THE COURT, LONG ESTABLISHED, ENTIRELY CONSISTENT WITH DUE PROCESS OF LAW; AND THIS COURT, ACCORDING TO PRECEDENT, SHOULD NOT INTERFERE WITH THE RESULT.

II

THE APPELLANT TOTALLY FAILED TO CARRY THE BURDEN WHICH RESTED UPON IT TO SHOW THAT IT DID NOT HAVE THE ACTUAL NET INCOME IN NORTH CAROLINA UPON WHICH THE STATE IMPOSED THE TAX; OR THAT THE INCIDENCE OF THE TAX UPON IT PRODUCED AN UNCONSTITUTIONAL RESULT. EVIDENCE OF GROSS OPERATING REVENUE IN NORTH CAROLINA WAS NOT ONLY RELEVANT BUT WAS REQUIRED OF THE RAILWAY.

III

THERE WAS NO MERIT IN THE CONTENTION OF THE APPELLANT ON ITS HEARING IN THE COURT BELOW UPON THE FACTS ASCERTAINED UPON THE TRIAL, NOR WAS ITS CONSTITUTIONAL RIGHTS INVADED.

ARGUMENT

I

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The North Carolina law is constitutional upon its face. It follows that the railroad company has no case unless it can show that the application of the statutory formula to its business produces an unconstitutional result.

Atlantic Coast Line R. R. Co. *v.* Doughton, 262 U. S. 413, 67 L. Ed. 1051;
Underwood Typewriter Co. *v.* Chamberlain, 254 U. S. 113, 65 L. Ed. 165;
Hans Rees Sons *v.* Maxwell, 283 U. S. 123, 75 L. Ed. 879.

The direct issue is raised as to whether or not the railway company for the three years in question had in the State of North Carolina the net income found by the application of the statutory formula and taxed by the State. The existence or nonexistence of such taxable net income must be shown by competent evidence, and the burden was upon the railway company to show it.

The ultimate fact at issue, therefore, is the existence or nonexistence, of taxable income in this State. Every other fact is evidentiary or incidental to this question, and while necessary to be considered, need not be separately found.

The court below considered and found all facts necessary to determine the issue presented—whether the railway had in this State the net income taxed, and whether this appellant had carried the burden which rested on it to show that it did not have such income. The ultimate fact at issue, not the evidentiary facts, is important, and the finding of such ultimate fact satisfies the law.

Briefly, the complaint of appellant is that it was entitled, as a matter of law, to a finding in dollars and cents of the aggregate of operating expenses, and a finding in dollars and cents of the gross operating revenues. There are several good reasons why this is not true.

First, in this case, the Railway did not put itself in any position to demand it or make it proper. It simply introduced evidence tending to show operating expenses and none to show operating revenues, denying the right of the State to do so. The Railway simply demands that the mileage prorate figure of gross revenues be found as the correct amount of actual gross revenues and the actual expenses claimed to be proved deducted from it. The legal and logical impropriety of this method is discussed elsewhere. (Page 30.) The Railway presents evidence of expenses only, and a finding as to expenses only is utterly without significance, as it does not follow that gross operating revenues may not be correspondingly larger.

In the second place, it is not necessary under the procedure in this State (and this jurisdiction is not at all peculiar in that respect), that evidentiary facts be separately determined, and that is true no matter whether the trial is before a jury or under reference, as this was, and reviewed by the Judge at term. It is necessary only that the ultimate fact at issue be determined. In this case that ultimate fact related to the presence or absence of net income within the taxing State.

From the lack of proper development of this case by the Railway on the trial below, the failure to deal satisfactorily with the matter of operating revenues in such a way as to show that they were not sufficient to sustain the tax, a negative finding would have been sufficient. The positive finding in the record was, however, justified by the evidence.

As this is the principle, practically the only point on which this appellant depends for jurisdiction of this Court, (see Answer to Appellee's Statement of Facts Making Against the Jurisdiction of the Court), we beg to point out that the action of the Trial Judge (who, by motion of this appellant, sat at both court and jury) was procedurally correct.

That a general finding in a reference case of this nature is free from error is logical and sufficient, in view of the foregoing consideration, cannot be questioned. That it is sufficient in law, and approved in practice, is equally true. See authorities p. 28, this brief.

There is no controversy between the State and this appellant as to the burden of proof.

There is a difference, however, between the State and appellant as to the manner in which the Railway Company may show the existence or nonexistence of net taxable income; that is, as to how the Railway may make out its case. The State contends that it must show by competent evidence, both as to expenses and as to revenues, the *facts* from which net income may be ascertained, as such net income has been defined by the laws of the State. The Railroad Company contends that it may show its actual net income in this State without reference to its actual gross revenues, but by using the formula which it is attacking which allocates a mileage prorate of gross revenue, for administrative purposes.

As this is argued fully elsewhere (see brief p. 30), we merely refer to it here as preliminary to the discussion under this head and to make the discussion under this head more easily understood.

Appellant has vigorously attacked the procedure of the State Courts, in which the actual trial upon the evidence was had. It will be necessary, therefore, to review that procedure with special reference to the objections which have been raised. In so doing, we must observe that the objections to the proceeding in the State Courts do not involve or discover any matter or principle which this Court has heretofore considered within its province to deal with on an appeal from the State Court.

First of all, let us say that in none of this proceeding in the court below was there any evidence of any character, offered by the appellant, rejected or excluded.

In the court below this was a reference case, compulsory in so far as the State is concerned. Obviously the criticisms upon the procedure grow out of a misunderstanding of the North Carolina procedure in such matters, and the authority and the functions of the Referee and the Presiding Judge who reviewed the Referee's Report. The North Carolina procedure is precisely the same which obtains in many other state jurisdictions, and its constitutionality and its perfect agreement with the requirements of due process are beyond question. The criticisms made upon the procedure have no legal support, either State or Federal.

Fairly considered, these objections reflect little more than a persistent feeling of disappointment that the findings of the Referee were set aside. In this feeling we do not share; but we do point out that under our statute of reference, and the decisions of the Court, the Judge who reviewed this case in the capacity both of court and jury had the power

to set aside the Referee's Report and find the facts, and doubtless exercised it according to his own judgment and conscience, and certainly did so with far greater respect for the facts and the proper inferences to be drawn from evidence.

This method of settling the case was chosen by appellant. The record will disclose that it was a compulsory reference, instigated by the Railway Company. R. p. 45. Objection was made by the State. The Railway Company was, therefore, bound by the findings of fact and knew that in the proceeding the findings of the Referee were subject to be set aside and findings of the Court substituted therefor, and as to this, it definitely waived a jury trial. Subsequently, the State waived its right to a jury trial and thus put itself on all fours with the Railway Company in its chosen method of trial.

For convenient reference, we will attempt to classify the objections to the procedure in the court below which appellant claims gives it the right to appeal to this Court for correction:

1. That the reviewing judge set aside findings of fact which were "admitted" by the State. Appellant's brief frequently refers to "admissions" by the State which the record discloses were never made.

In this particular instance, the appellant is referring to its aggregate of gross operating expenses, as will be seen by reference to appellant's brief, page 8. There the witness, Roberts, simply stated that these figures as to operating expenses "might be accepted at face value without being seriously misleading as respects the *relation* of operating expenses on the branch lines to those on the main lines of the system." Thereupon, the brief immediately interprets this as an admission on the part of the State that

"the operating expenses of the Railway's branch lines entering the State are higher *than is indicated by the statutory formula.*" That is manifestly untrue, because the statutory formula, i.e. the system ratio itself, without any reference at all to the mileage prorate, involves a comparison with revenue. No matter what figure may be accepted for costs, the question of whether or not this system ratio properly applies to the Railroad's business in the State must necessarily take in the revenue earned in the State, as well as the costs expended; and the fact, if known, that costs of operation were higher in North Carolina is utterly without significance, unless that is related to the revenue earned.

There has been no attempt on the part of the State to evade or deny the fact that operating expenses in North Carolina may be higher than they are on level portions of the appellant's main lines, certainly not anyways near the extent to which the Railway claims; nor is it anywhere admitted that the aggregate of costs in this record are anywhere nearly accurate, or that they have been developed on a fair or admissible method. Elsewhere we have pointed out (our brief p. 30) the total fallacy of the method invented and used by the Railway Company to determine and aggregate these alleged expenses. We have not stressed this, because we did not wish to cause any confusion as to the necessity for the Railway Company to show the other side, or the other element, which is clearly necessary to disclose the facts as to net income in this State: that is the actual gross revenue produced in this State (which is a factor as essential to the finding of net as the factor of expenses), and to contend in this respect two things:

(1) That it was logically and legally essential that the Railway Company develop the facts as to such gross revenue; and

(2) Whether it developed them or not, the amount of gross revenues enjoyed by the appellant in this State, and

properly assignable to it, were sufficiently larger than the formulated revenue to preserve the integrity of the fraction known as the system ratio. At any rate, the formula referred to by the appellant in the second paragraph on this page is the system ratio, and just as the relation between actual system expenses and actual system revenue constitutes that formula, just so it must be tested by that same relationship in any territory where the inapplicability of the ratio is challenged.

2. The trial court, on review of Referee's Report, found all facts necessary to determine the issue. It is contended that the Railway Company was entitled, as a matter of law, to specific findings of fact; first, with regard to statutory gross operating revenues within the State, and, second, with regard to operating expenses attributed to the earnings of such gross revenue.

As applied to the finding of gross revenue, this statement is paradoxical, in view of the fact that the appellant in the court below furnished no evidence whatever as to its gross revenues from which the Court can find any sum. Appellant's contention, to which answer is made elsewhere in this brief (p. 30) is that the Court was compelled to find that the gross operating revenues in North Carolina to be the formulated mileage prorate revenue determined by the formula for administrative purposes. This is fully dealt with elsewhere in this brief, and will not be considered further here except to specifically answer the citations of authority which are addressed to this point.

In connection with appellant's contention that the mileage prorate figure as to gross revenue should have been adopted by the Court as a finding of fact, the brief makes the erroneous assertion that Commissioner Maxwell *admitted* its correctness as representing actual gross revenue in this State. The reference is to an expression in the Commissioner's order overruling the Railway's protest.

Apart from the fact that the so-called admission is not in any pleading and that the Commissioner could make no such admission for the State, the statement in the brief is wholly incorrect. The Commissioner went no further than to say that the formula had been correctly applied and that the figures produced were in accordance therewith:

"The statute has been followed in setting up gross revenue." R. p. 27.

Even this turned out to be incorrect, as the Railway, in response to a criticism by the witness Roberts, admitted that it had used a punch card device for dealing with revenue, in connection with mechanism supposed to give an aggregate of revenue when the cards were fed through it. Through error, transactions not touching North Carolina were included, bringing in lean traffic outside and diluting the richer North Carolina traffic. The ensuing correction added thousands of dollars to even the formula determined North Carolina revenue.

Atlantic Coast Line Railroad Co. *v.* Doughton, 262 U. S., 413, 67 L. Ed. 1051, at page 422, simply lays down as a proposition that any statute which taxes net income must clearly provide how it shall be ascertained, that is to say, define gross income and state what deductions must be made to find net income. It cannot be twisted into any authority for the proposition that the statutory gross income, that is to say, the gross income ascertained administratively by the application of a formula, can be used in any case where the application of the statute itself has been attacked as unconstitutional, or, in fact, as any case at all as a substitute for the actual facts as to gross income or revenue. Specifically the complaint of this appellant is that this was not done in this case.

Nor is this statute any authority for the position that it is necessary for the court below in its findings of fact to set up specifically facts which are merely evidentiary and

which, however largely they must enter into the consideration of the Court, are but inducive to the ultimate fact which it is the duty of the Court to find. The ultimate fact in this case was that of net income; not necessarily to be stated in dollars and cents, because this Court had nothing whatever to do with the finding of net revenue for purposes of taxation, but merely to find whether or not the Railway Company had net income for the taxable years substantially as large as the State had taxed. This the Court determined.

Whether or not the Court was satisfied with the statement or aggregate of expenses made by the appellant in this case is not a necessary subject of inquiry. We have dealt elsewhere with the manner in which the appellant attempted to aggregate this expense and have shown that it was clearly contrary to any proper accounting, unjust and unfair and that it arbitrarily set up against the prorated part of North Carolina revenue, whatever it might be, substantial sums of expense which ought to have been charged, in part at least, to the total revenue produced by the interstate hauls; but even if the Court had accepted it and had found it in dollars and cents in a separate finding of fact, the position of this appellant would not have been thereby improved, as it furnished no other figures of gross operative revenue from which a deduction could be made and the net ascertained. Standing alone, it is utterly without significance.

3. That the Court could not set aside specific findings of fact by the Referee without substituting specific findings in their place.

The findings of the Referee, when set aside by the Court, are entirely without significance. Under the procedure of the North Carolina Court, and indeed of other Courts having similar laws, the power of the reviewing judge to set aside the findings of the Referee, and make such findings as it may see fit upon the evidence, is not limited by any regard

for any specific finding of fact by the Referee. In this respect, the Court may not only make such findings as it may seem to it relevant to the ultimate issue involved, but in doing so it is not bound by the plan or scheme or schedule adopted by the Referee in his report or in making his findings; nor was it required to substitute any finding of fact for any one found by the Referee, or to designate any one of them, or all of them, specifically as having been set aside.

C. S. 578 (Michie's North Carolina Code of 1935) Appendix .....;
Cummings *v.* Swepson, 124 N. C. 579, 32 S. E. 966;
Wallace *v.* Benner, 200 N. C. 124, 156 S. E. 795;
Thigpen *v.* Farmer's Banking Co., 203 N. C. 291, 165 S. E. 720.

We may further say here with reference to criticisms of the evidence introduced in this case, and before the Court for its review, that while numerous objections were made on both sides during the progress of the trial to certain parts of the evidence before the Referee, this appellant filed no objections or exceptions whatever to the report of the Referee or to anything that it had done in it, as such report was favorable to the appellant, and did not call to the attention of the Court any of its objections to the testimony before the Referee and, therefore, waived any objection to them.

Wallace *v.* Douglas, 103 N. C. 19, 9 S. E. 453;
McNeill *v.* Hodges, 105 N. C. 52, 11 S. E. 265;
Baker *v.* Edwards, 176 N. C. 229, 97 S. E. 610.

The total of operating expenses and the total of gross revenue, had any figures been furnished to the Court by the appellant in that respect, are, of course, necessary to be considered, but they were but evidentiary matters. The fact

was net income and the Court made sufficient finding as to that. That a general finding is sufficient, we cite:

Bancroft *v.* Roberts, 46 N. C. 363;
Vest *v.* Cooper, 75 N. C. 519;
Caruth-Byrnes Hardware Co. *v.* Walter, 91 Mo. 844;
Pitt *v.* Lansdale, 32 Ind. 218;
Hihn *v.* Peck, 30 Calif. 280;
United States *v.* Ramsay, 158 Fed. 488.

4. That the trial court made findings of fact upon insufficient evidence.

Here appellant doubtless refers to the finding that, considering the evidence as to expenses and gross revenues, the latter were sufficiently larger than the former to produce the amount of net income taxed.

To understand this we must refer again to the Railway's contention that to make out its case it had the legal right to depend on the allocated revenue figure produced by the mileage prorate formula as necessarily showing the Railway's gross income in this State, as the revenue figure produced has only a conventional relation to actual North Carolina gross operating revenues which may or may not be correct.

There is the further contention in this that the State was not permitted to "abandon the statute" as to gross revenue in North Carolina, no matter what the actual facts to the Railway's gross revenues were, and how much understated by the formula, and that the Railway had no duties or burden in the trial court as to its gross revenues, although they may be, and really were according to the evidence, sufficient to reflect a much larger net income than that taxed.

But, reflecting that the burden of showing that it did not have the net income taxed in this State rested upon the Railway, if all evidence as to actual gross revenue is stricken

from the record, as appellant contends it should be, what becomes of appellant's case? A mere negative finding is all that the Railway would be entitled to. The finding of the Court that it did have such revenue would not then be material.

But there was abundant evidence to support the finding, and we take this up in answer to appellant's Statement III, relating to the alleged irrelevance of testimony as to actual gross operating revenues. (Our brief pp. 45 to 56.)

Concluding this section of the brief, we respectfully submit that no infraction whatever of court procedure has attended the trial in the courts below, nor was there any constitutional right of this appellant withheld from it or invaded. Conceding, of course, the right of the Railway Company to contest the constitutionality of the taxing law as applied to its business, we respectfully submit that such a contest raises issues of fact which are properly triable in the State Court, and this Court will not disturb that jurisdiction when upon the whole the questions involved relate to procedure, as they do here, and that procedure is consonant with due process of law.

Cincinnati Street R. R. Co. *v.* Snell, 193 U. S. 30, 48 L. Ed. 604;

Central Vermont R. R. Co. *v.* White, 238 U. S. 507, 59 L. Ed. 1433;

Lee *v.* Central of Georgia R. R. Co., 252 U. S. 109, 64 L. Ed. 482;

Kentucky Finance Cor. *v.* Paramount A. Exc. Cor., 262 U. S. 554, 67 L. Ed. 482;

Power Mfg. Co. *v.* Saunders, 274 U. S. 491, 71 L. Ed. 1165.

II

THE APPELLANT FAILED TO CARRY THE BURDEN WHICH RESTED UPON IT TO SHOW THAT IT DID NOT HAVE THE NET INCOME IN NORTH CAROLINA UPON WHICH THE STATE IMPOSED THE TAX; OR THAT THE APPLICATION OF THE TAXING FORMULA TO ITS BUSINESS PRODUCED AN UNCONSTITUTIONAL RESULT. EVIDENCE AS TO THE RAILWAY'S GROSS OPERATING REVENUES WAS NOT ONLY RELEVANT, IT WAS REQUIRED OF THE RAILWAY TO SUSTAIN ITS CONTENTION IN THIS CASE.

A

If we are correct in saying it was necessary for the Railway to establish that it did not have the net income in this State, or properly attributable to this State, upon which the State imposed the tax, the case should end here as a matter of law. This is the burden which rests upon any taxpayer who seeks to defeat the tax on the ground that the statutory formula is not suited for application to its business, and in its application works an unconstitutional hardship upon him, or confiscates his property under the guise of taxation.

> Underwood Typewriter Co. *v.* Chamberlain, 254 U. S. 113, 65 L. Ed. 165.

The attempt made by the Railway to attack the statute as working an unconstitutional hardship upon it and at the same time take the benefit of a portion of it detached from its context for proof which it is required to furnish on the trial of that issue, is paradoxical, unauthorized and unsound.

In our preliminary statement, ("Principal Question Involved," page 4 of this brief), we dealt with the manner in which the Railway attempted to carry this burden in the trial. Instead of trying to prove any facts with re-

gard to its gross operating revenues in this State, it sought simply to rely upon a fractional part of the North Carolina Revenue statute, or allocation formula, by which an averaged mileage prorate of interstate gross operating expenses is allotted to North Carolina, for administrative purposes, in levying the tax.

While the necessities of administration in allocating interstate income for taxing purposes gives rise to conventional formulae for that purpose, no necessity of proof in a court trial can justify the use of such a formula as a substitute for evidence, in any case, more especially a case involving the constitutionality of the result produced by the administrative application of the formula which is itself attacked.

The North Carolina formula is as follows:

> "And when their business is in part within and in part without the State, their net income within this State shall be ascertained by taking their gross operating revenues within the State, including in their gross operating revenues within this State the equal mileage proportion within this State of their interstate business and deducting from their gross operating revenues the proportionate average of operating expenses or operating ratio for their whole business, as shown by the Interstate Commerce Commission Standard Classification of Accounts."

The mileage prorate, it must be remembered, deals only with mileage concerned with interstate traffic partly in North Carolina, and the total revenue prorated deals only with revenue from such traffic. There is no controversy about this.

The formula is a compound fraction, completely interdependent in its parts.

It is completely administrative and conventional, and admittedly may be right or wrong as applied to the business of any particular taxpayer, and such taxpayer has the right

to challenge its correctness as applied to his business, although it has been upheld as not unconstitutional per se in a suit to which this Railway was a party: A. C. L. Railway *v.* Doughton, supra. *But such a taxpayer challenges and tests in a suitable court the result of the whole statute as applied to his business and not a part of it.*

The mileage prorate part of the formula was designed for use solely with the other part relating to expenses. The Supreme Court of North Carolina held that the formula is not separable and that the fractional part of the statute was not susceptible to the use which plaintiff in error desired to make of it in the lower court; that it was not competent for the purpose of ascertaining gross operating revenue when the statute was being tested in court as to the constitutionality of its application, and that it did not estop either from showing by proper proof what the actual gross operating revenue actually was, or of showing that it was either sufficient or insufficient to produce the actual net revenue taxed.

Like other allocation statutes which have been recognized by this Court as valid, the statute was devised to meet an administrative difficulty that always attends the ascertainment of allocable income to any taxing State where as in this case the business is unitary and the income the result of continuous operations arising in one State and terminating in another. As to such a statute, it is always competent for a taxpayer, if it can, to show that the application of the statute to its business produces an unconstitutional result. Such a showing, however, is in its every aspect in the realm of fact and not of convention; and no sort of fairness would result from splitting up the statute so that on one side the taxpayer might show actual expenses, and on the other side take a mere allocation of averaged revenue as representing the facts of gross income.

To understand the inseparability of mileage prorate part of the statute from the rest of the formula, we observe that

the statute does not assume that either gross operating revenue or operating expenses, taken separately, are uniform throughout the system. It does assume, however, that there is such a uniformity of relation between the two throughout the system.

This is in complete accord with experience in any widely extended business carried on with sound judgment. The principle is abundantly established in railroad practice; and it is remarkably sustained by the evidence in this case, where it was shown that the gross operating revenues of this Railway Company, during the prosperous years of 1927, 1928 and 1929 were very much greater than the mileage prorate, although it may have also shown that the expenses were also larger. The fact that this appellant is accustomed to rely on the fairness and logic of this principle to justify the higher rates it charged, and the superior revenue it collected in North Carolina will fully appear when we come to consider certain controversies before the Interstate Commerce Commission to which appellant calls our attention. (Our brief, pages 54, et seq).

It is easy to see that the formula in the particular case might understate the expenses or, on the other hand, might understate the revenues; or it might overstate either; or it might overstate one and understate the other. It is perfectly legitimate for a taxpayer to show in court that it understates or overstates either the expense factor or the gross revenues; but, so long as the relation between the expenses and the revenues maintain the relation which the statute assumes, the taxpayer has no cause of complaint.

As to such a statute, it is, of course, always competent for the taxpayer, if it can, to show that the actual application of the statute to it produces an unconstitutional result. Such a showing, however, is in its every aspect in the realm of fact and not of convention, and no sort of fairness would result in splitting up such a statute so that on one side the

taxpayer might show actual expenses and on the other side take advantage of a mere allocation of averaged revenue as representing the facts.

The fallacy of the method which the Railway Company seeks to use to test the validity of the statute as applied to it, becomes more apparent when we consider alone that part of the formula which relates to system ratio, and upon which the direct attack is made. The system ratio is itself, (without reference to any other part of the formula), a fraction, the numerator of which is system expenses, and the denominator system revenue. The Railway Company has undertaken to show that this is not applicable to its North Carolina business. The item of revenue, therefore, enters into this problem in a direct way; and the development of an aggregate of expenses, however large, standing alone, has utterly no significance, in the absence of the other part of the fraction—that is, the denominator of revenue with which it can be compared. Thus, it becomes clear that, in response to the attack of the Railway Company upon the "system ratio" as being inapplicable in its case, we are dealing with the relationship between the numerator and denominator of a fraction, and it seems to us absurd to place any other interpretation upon even this portion of the statute, other than to say that it is the *uniformity of the relationship* between expenses and revenues which is assumed by the statute, and which must be defeated and overcome by the Railway Company according to its challenge. The plain inference to be drawn from the statute, and this is the only inference that is consistent with any sort of justice to any person, is that the validity of the application of the statute cannot be defeated unless it is shown by the Railway Company that this ratio between expenses and revenue does not exist in North Carolina. That, of course, means the actual North Carolina expenses matched

against the actual North Carolina revenue, just as the fraction or ratio itself was developed from actual system expenses against actual system revenues.

Approaching the subject from this angle, we think the fallacy of the attempt of the Railway to depend upon the mileage prorate formulated revenue can be more clearly seen.

Appellant has not improved its position in any way by ignoring the true nature of the ratio between costs and revenue represented by the "system ratio"—the refusal to recognize that the test of its applicability in its case is whether or not it holds true as to its North Carolina business, both operating expenses and gross revenues—North Carolina revenues, not a prorated part of system revenues derived by the application of an administrative formula.

Appellant, as we say, does not improve its position by shifting the emphasis to the mileage prorate part of the statute with the claim that it may use this in lieu of evidence as to its actual gross revenue in North Carolina, upon the theory that it is inconvenient, or even impossible, for it to prove its actual income in North Carolina by proper evidence, or the theory that the State established that way of finding it in the statute and is, therefore, estopped from denying it, or any other theory that would make the statute which appellant has attacked usable for any purpose whatever, except for the purpose for which it was designed and authorized, namely, for the conventional ascertainment of income for administrative purposes.

B

Referring to the observations of the witness Roberts, appellant's brief, pp. 24, 25, in which is expressed the fallacy of the Railway Company's method of substituting the

formulated mileage prorate gross revenues for actual revenues in a test of the applicability of the statute, the writer of the brief naively exclaims:

> "—the State may not baldly abandon the statute and impose upon the Railway the burden of negativing the existence of net income in North Carolina upon any theory devised by the State's expert witness."

And yet that is just what the Railway undertook to do —namely, to negative the existence of net income in North Carolina taxed by the statute. That is its allegation in this case, that is the burden resting upon it; and the Railway Company "baldly abandons" the statute on the question of expenses and attempts to cling to it as to revenues.

The adjectival assault made on this witness will, I imagine, have no effect upon the weight and logic of his reasoning. The witness, as competent an expert as may be had in this country, merely points out from the viewpoint of accounting and of actual fact relations the want of intelligent result in using the statutory formula in the manner proposed by this appellant, and shows such result to be meaningless. His statement is well within the legitimate scope of his testimony as an expert witness, made after a thorough examination of the matters involved, and the record of the Company, and stands here without any objection made in apt time either to its competency or relevance. The statement follows below, and we should like to point out that there is no attempt whatever to answer it. We quote it here as an additional reason, out of the fact situation, supplementing our argument made from a legal point of view as to the inadmissibility of the method chosen by appellant in the court below to make out its case by substi-

tuting a part of the formula which it is attacking for evidence as to gross operating revenue. Record, p. 463.

> "If a test is to be made of the reasonableness of the statutory formula's use of the system operating ratio, that ratio must be applied to Actual Gross Revenue (not a mileage prorate of system gross revenue) to produce an operating expense factor which is comparable with Actual Operating Expenses in the State. Our ratio would then be:
>
> Actual Expense: Actual Gross Revenue.
>
> The Railway's witness would use the ratio,
>
> Actual Expense: Averaged Gross Revenue;
>
> Whereas the statutory formula employs the ratio,
>
> Averaged Expense: Averaged Gross Revenue."

In testing the State statute, it is fair or unfair, according to its ultimate results. The necessity for considering both revenue and expenses, if the statutory formula is to be disregarded, and particularly as to the peculiar operations of this appellant, is clearly and forcefully stated by witness Roberts, p. 43-4 of the record, as follows:

> "There is another aspect of this matter which the Railway's representatives have not taken into consideration. It has a more important bearing upon the propriety of using the system operating ratio to determine taxable income in North Carolina than the probable degree of error in the gross revenue which the Railway's method apportions to the State.
>
> "This phase of the subject may be approached by saying that the NET REVENUE which may with propriety be included in Taxable Income is the difference between gross revenues actually earned, and the actual expenses which earned them.
>
> "Now, if freight rates which produce gross revenue were assessed on an absolutely uniform basis per unit of service, as for example 1c per net ton-mile, and recognized no differentiations whatever on account of route of movement, length of haul, class of traffic or

quality of service, in that event gross revenue apportioned on a miles-hauled basis would unquestionably represent the gross revenue earned in the State to which assigned, whatever might be the relation of the actual expense to the revenue, or the expense levels obtaining on other parts of the railroad. In such a case, comparison of a State's actual expenses with a mileage prorate of gross revenue would not be illogical, or incompatible with attendant circumstances. The Railway's contention here would fit into such a situation.

"However, that is not the situation existing in this case. The revenues accruing from interstate traffic which is transported partly in and partly outside the State, and from intrastate as well as interstate traffic which is transported wholly within the State, do not accrue from rates fixed on a uniform and inflexible basis with total disregard of the expense incident to the service performed. In fact, the contrary is true. Freight rates lawfully assessed by the Railway for transporting freight over the branch lines serving North Carolina are on a much higher level than rates assessed for the same quantity and quality of service on other portions of its system. This was true for the years 1927, 1928 and 1929, and for years prior and subsequent to that period. For that reason, when the actual expense of operations on the branch lines, and within the boundaries of North Carolina, are considered, there must be considered coincidentally the actual gross revenue which such expenses produce, because actual expenses on the one hand, and a mileage prorate of revenue on the other hand, are wholly incompatible and their relationship is irrelevant."

There is one bit of credit due the findings of fact by the Referee, although they disappeared as factors in this case upon being overruled by the trial court; the defendant in that case, this appellant, got no more out of the reference than it put into it. The Railway would be in no better case

here had the crucial finding of the Referee stood. We quote it, as appellant conceives it to be its "high spot" on the trial below:

"For the years 1928 and 1929 these figures," that is the Railway's bizarre set up of "operating ~~revenues~~ expenses,"—"excluding taxes, are in excess of the North Carolina gross revenues *ascertained by the method prescribed by the statute*, and for the year 1927, including taxes, are in excess of such revenues."

Thus do both the Referee and the Railway disregard entirely the requirement that the actual condition of its business in this State was the subject of inquiry, and close the door to any examination of its gross operating revenues by the Court.

For the purpose of settling the issue raised by the Railway, the finding of the Referee amounted to exactly nothing, even if the Court had not, in the exercise of its own unquestioned jurisdiction, set it aside.

There are two approaches which the Railway has made in trying to sustain its position as to the propriety of substituting the mileage prorate result for other proof of revenue that may be considered here.

(a) First, it seems to be contending in the brief that the mileage prorate is an impeccable method of ascertaining gross operating expenses with invariable correctness. The witness Keeley is called upon to aid counsel in that view.

On page 35 of appellant's brief the mileage prorate end of the allocation formula comes in for much praise:

"The mileage unit for allocation for gross revenue produces a gross product of operation within the State in a practical way—in the only practical way—as the witnesses, Roberts and Keeley, demonstrated. The mileage unit of measure gives weight to volume of business, to the distance

hauled in and outside of the State, and so ascertains the gross revenue proportioned to that part of the effort expended within the State. And, again, the income tax statute here under consideration contains in fact two distinct units of measure: First, the gross revenue of interstate shipments touching the State is apportioned by the unit of distance and mileage of each of such shipments within and outside the State *on the practical assumption that the revenue is evenly earned throughout the haul,*" etc.

The good character which the brief here gives the mileage prorate result cannot be attributed to either Roberts or Keeley. Roberts stated that it could be easily proved not to hold in this State as it much understated the revenues, and Keeley said nothing about it.

As a matter of fact it is not even plausible. The State has never contended that the revenue earned was invariable per "unit distance of mileage" over the system. No one outside of this brief ever attempted to maintain such an unreasonable contention.

The State has contended that there is a uniform relation throughout the system between expenses and revenue and has freely admitted that it was easy to disprove that the mileage prorate allocation taken separately is true for this State just as the Railway attempts to prove that the expense part of the formula is variable.

(b) In the second place, the Railway attempts to maintain the right to use the mileage prorate result as a substitute for actual revenue by citation of cases bearing on administrative phases of tax assessment, apparently contending that these controlled the Court in its judicial investigation of the facts. Counsel might as well contend that the statutory formula relating to system ratio also bound the Court in its investigation and we should then find the investigation "coming out of the same hole it went in at."

Appellant's brief quotes from Preston *v.* Sturges, 133 Fed. 1:

"Each step in the process of taxation from beginning to end can be taken only as the legislature may prescribe."

We agree with him thoroughly, but we disagree with counsel attempts to carry the rules and restrictions of administrative assessment into a court trial, the sole purpose of which is to test the validity of the statute itself as applied to the taxpayer's business. On such a trial they are wholly inappropriate and without authority in determining the facts at issue.

No justice can be done either the State or the taxpayer unless we deal with facts. In doing this the Court is not impeded by administration of allocation formula. It has nothing to do with such formula except to measure the results of their application by the facts of the case.

The trial court had no power to find any amount of net income for the purpose of taxation and no occasion to follow an administrative formula. Its sole function was to ascertain fully the facts of the case upon the issue joined.

May we say here that the legislature did not invest the statute with any force or function as an instrument of proof; and the Supreme Court of North Carolina interpreting it in this case has declared that it is not available for such use.

It is suggested that the Railway might have the right to use this method because it met with difficulty in producing satisfactory evidence of its gross revenues. Our position on this point is simple and, we think, sound: While the necessity of allocating interstate income has given rise to the use of allocation statutes, conventional in their character, which the courts have approved for such administrative purpose only, no necessity arising out of the production of proof in a court or trial or judicial investigation can

authorize or justify the use of such a statute as a substitute for evidence; more particularly when we consider that it is the very statute under review.

Nothing could more clearly demonstrate the misconception of counsel as to the North Carolina statute and the functions of the Court in the investigation of the constitutionality of that statute as applied to the railway business than the statement which may be found on page 33 of the brief:

> "The Railway Company is suing the Commissioner in this case to recover a specific sum assessed and paid under the income tax formula, which the State, in effect, admits it cannot defend."

(Here again the same mis-statement as to admissions of the State:)

> "But the assumptions and data on which the Roberts calculations are based have been shown to be inadequate *for any alternative assessment* on which to base any tax."

We have here a renewal of the contention which appellant failed to get across in the court below, to-wit: That the Court should find some definite figure of net income *for purposes of taxation.* There is no "alternative assessment," and no statute has authorized the Court to do anything about it. If the Court might do so, if that were a part of its functions, we might agree that a specific finding of net, or a specific finding of the factors of operating expenses and gross income out of which net could be determined, might be necessary. Even then, the mileage prorate gross would not be a proper response, for reasons fully argued, and the appellant offered nothing else.

Why, then, should appellant contend that it has established anything at all with reference to its net income in this State, or whether it was none at all, or as much as taxed, or more, by simply showing its operating expenses.

It seems to us that the statement made by appellant on page 16 of the brief, to the effect that it is entitled as a matter of law to specific findings of fact with regard to statutory "gross operating revenues" within the State and "operating expenses" attributable to the earning of such gross revenues, may be answered in a simple and direct way, which shows the fallacy of the contention.

What are the factual situations which upon the Railway contention the Judge is called upon to find the facts:

1. What was the gross revenue of the Railway on its North Carolina interstate business?

2. What was the gross deductible expense of the Railway?

Both questions are pertinent to each of the taxable years 1927, 1928, and 1929.

As to the issue number 1, the Railway offers no proof. It relies upon the statutory formula. As to the issue number 2, a great mass of testimony was offered by the Railway and the State as well.

The Railway's attempts to set up these costs are purely arbitrarily, following a plan of its own selection—and based upon many assumed and ignored relationships of varying factors in what might be properly fixed as North Carolina costs.

The result: A practical impossibility for any court to find in dollars and cents the actual costs properly to be ascribed to North Carolina business. Taking, however, the aggregate for this argument at the figures stated by the Railway, we have no revenue figures from which to deduct it.

Meeting this impasse, the trial judge finds that the Railway has failed to establish those facts which it is called upon to prove.

Turning now to this issue, what was the taxable net revenue of the Railway for the years in question?

The North Carolina formula admittedly provides the answers in dollars, the figures for each year in which the tax was levied and paid. The Railway protest asserts that the net thus determined is not real, and complains because the Superior Court found it impossible to ascertain approximate revenues or expenses in our totals.

The Railway complains because the Court did not find the dollar cost of its operations in North Carolina for the three-year period. *It was not incumbent upon the Court to make any findings as to deductible expense until the Railway had shown first the actual North Carolina revenues from which the deductions would be made.* There was nothing for the Court to do except that which it did.

It is said in Atlantic Coast Line Ry. Co. *v.* Doughton, 262 U. S. 413, as quoted by this appellant on page 17 of its brief:

> "Every income tax act necessarily defines what is included in GROSS INCOME; what deductions are to be made from the gross income to ascertain net income."

The first process in arriving at net, therefore, is, first to fix beyond a misunderstanding, and with definitive precision what the gross income is. The next step is to provide what deductions are to be made from it. The difference is taxable net.

Because this Railway contended in Atlantic Coast Line Ry. Co. *v.* Doughton, *supra*, that other items should have been included in this statute within gross income, and certain other items necessarily should have been included in the deductions, it was necessary for the Court to approve of the definition of gross income found in this statute in that case, and this it did. The Court then proceeded to the item of deductions and found them reasonable.

It is clear, then, that we cannot reverse this process with any logic, not any more in a case involving actual revenue and actual expenses than we can under the administrative

statute. We must first find, or somewhere, at least, find a definite gross income, and then take from it the deductions which are allowed by law. The Railway Company in this case has not presented evidence from which the Court could find such gross income, and the deductions claimed, however large the figures may be, stand alone and without any significance. This means, of course, that in this case the Railway Company has not enabled the Court, by proper findings, to make the specific findings which it demands of it. It is to be noted here that the complaint of the Railway Company is not that the Court did not find the actual gross net operating expenses, but that it did not find the STATUTORY GROSS which it elsewhere calls the State Gross.

III.

THERE WAS NO MERIT IN THE CONTENTION OF THE APPELLANT ON THE HEARING IN THE COURT BELOW UPON THE FACTS ASCERTAINED BY THE TRIAL, AND ITS CONSTITUTIONAL RIGHTS HAVE NOT BEEN INVADED.

A

(a) Appellant's brief cites a number of cases under its division III addressed to its specifications of error 1 and 2, record pages 844-5, bearing upon the validity of the allocation laws of several states which have been tested in this Court. We readily admit some of such statutes are good and some bad. Some have been found unconstitutional *per se*, and others have been shown to be inapplicable to the taxpayer's burden. As the cases cited—Wallace *v.* Hines, Director General, 253 U. S. 66, 64 L. Ed. 782; Southern Railway Co. *v.* Kentucky, 274 U. S. 76, 71 L. Ed. 934; Union Tank Line Co. *v.* Wright, 249 U. S. 275, 63 L. Ed. 602—were based upon allocation statutes entirely different from the one we are discussing in this case and the facts were entirely different, their want of analogy to this case and lack

of any approach to the principle here involved is immediately apparent to the Court, which is here, of course, on familiar ground. They are franchise tax cases and involve an entirely different principle in that respect.

(b) Of the cases cited in appellant's brief, only Underwood Typewriter Co. *v.* Chamberlain, 254 U. S. 113, 65 L. Ed. 165; Maxwell *v.* Kent-Coffey Mfg. Co., 204 N. C. 365, 291 U. S. 642; and Hans-Rees Sons *v.* North Carolina, 283 U. S. 123, have any similarity to the case at bar.

The complaining taxpayer won in the Hans-Rees case because it was able to split up its activities into manufacturing, selling by wholesale and retail, and even re-manufacturing in another state; and was able to show its income arising from its activities in other states to form a large part, in fact the most of the income which had been arbitrarily attributed to North Carolina. In other words, the plaintiff in that case succeeded because it produced the evidence of its income which is wanting in the present case.

Both in the Underwood Typewriter case and in the Kent-Coffey case the complaining taxpayer failed because, just as the plaintiff in error in this case, they failed to show that their income in North Carolina might not justify the application of the formula.

B

(a) We call brief attention to the manner in which the Railroad Company made up the total of expenses. The Railroad Company made up a large total which it claimed represented its North Carolina expenses. It complains here that upon overruling the Referee's findings, the trial court did not adopt this as a finding of fact. It is true that the trial judge did not find in dollars the expenses of the Railroad Company in North Carolina. In the setup of this case, more particularly the theory on which this appellant insisted upon trying the case, and on account of its failure to present a suitable basis for deductions, this became unneces-

sary. It would be unnecessary anyway, as in the analysis of the evidence it would be a subordinate or conducive fact to the decision of the main fact or issue sought to be established; and the finding of the Court was conclusive as to this main fact.

We have hesitated to dwell at any length upon the figures of expense presented by the Railroad Company on the trial, for the further reason that if they are considered to be true, which they are not, appellant would still have failed to make out his case both on account of the failure to produce evidence of gross revenue and on account of the fact that the evidence in this regard presented by the State pointed overwhelmingly to the conclusion that actual gross operating revenues received in North Carolina were still so much in excess of the mileage prorate result as to produce a greater actual net income over operating expenses than that which the Commissioner taxed.

Not that it is essential to this case that we attack the expense aggregate insisted upon by the Railroad Company, nevertheless, there are many reasons why the court below, and why this Court, cannot accept that total with any proper feeling as to the propriety of the methods used or its reliability.

In the first place, the record discloses that when the Railroad Company filed its income tax return for the years in question (the starting point of the controversy and a part of the proceeding now under review, see record pp. 3 et seq.), that return, sworn to by its officers, as required by statute, set up $1,502,153.05 as its operating loss for the three years in question. When the case came on for trial, the Accounting Department of the Railroad Company had changed its mind and set up as the loss $193,890.40, a difference of $1,308,262.85 and on a comparative basis less than one-fifth of its original statement.

See pp. 17, 18, Appellant's Brief.

It clearly shows that given any objective, and using the totally unauthorized methods invented by the Railroad Company, any desired figure could be reached.

The reckless reduction of claims with respect to its operating expenses in North Carolina evidently arose as a matter of psychology—it could not in both instances be a matter of fact. In plain facts, no doubt, the larger figure appeared to be absurd, but of the lower figure it might be said:

> "'Tis not so deep as a well, nor so wide as a church door; but 'tis enough, 'twill serve."

The first step taken by the Railway Company in arriving at expenses was to totally disregard the fact that the North Carolina branches were not independent railways but were integral parts of the system, and as necessary to the interstate haul as were those parts beyond the State line included in interstate business. In many instances the Railway charged against the small pro rata share of North Carolina revenues the entire aggregate of expenses which ought to have been distributed over the haul.

With no books which could actually reflect the expenses properly assignable to North Carolina, the Railroad Company used two methods in setting up the expense total:

The first was to recognize the State line as a physical boundary, setting up against the State expenses which it could show were paid south of that line, regardless of the fact that its traffic and transactions regarded no such physical boundary.

The second was to use a prorating and allocation method of its own, attempting to refer to North Carolina its pro rata part of expenses incurred between certain points inside and outside the State, regardless of the extent, direction, or volume of the interstate business in which North Carolina participated. The device was to take the division figures of expense and allocate to North Carolina such part as the accountant thought fair.

The setup is in utter violation of the unit rule, of the unitary use of those expenses which were factors in earning revenue outside the State through the expenses out of any sort of philosophical or functional relation to the revenues which they produced, and enabled the Railroad Company to charge items of expense in North Carolina which produced the interstate revenues; not to the entire revenue which it produced, but solely to the North Carolina mileage prorate of such revenue.

But, we do not desire to divert the attention of the Court on the main points of this case necessary for its consideration, and we repeat, that while the finding in dollars of the appellant's total expenses in North Carolina is not essential to the finding of the main issue, inasmuch as it was duly and fairly considered by the Court in arriving at its conclusion of law, and the facts found by the Court showed that it was so considered, nevertheless, if such total should be accepted as correct and proper, it does not help the appellant in any way at all in his present situation either as a matter of law or as considered as a matter of evidence in the court below, where it was taken and considered in the finding of fact upon the issue before the Court and found adversely to the appellant here. We repeat that deductible expenses standing alone are without significance.

(b.) Turning to the evidence bearing upon the Railway's revenues in North Carolina, we call attention briefly to the following pertinent facts which this investigation disclosed, and which were before the Court upon the trial:

The Norfolk and Western Railroad Company operates an extensive system, its lines lying in North Carolina, Virginia, West Virginia, Maryland, Ohio, and Kentucky. Its lines in North Carolina are branch lines known as the Abingdon Branch, the Winston-Salem Branch and the Durham Branch. The two branches last named have terminals in populous manufacturing and trading towns, centers them-

selves of industry and trade, where the Norfolk and Western Railroad forms important connections with the principal railways traversing this State.

The topography of the country traversed by the Railway shows a variation from mountainous to hilly, and to level. The branches in North Carolina have more grades than the level territory in which a part, but not all, of the main lines are located; but coal hauled into North Carolina comes out of mountainous territory outside of the State, and is largely transported over branch lines through such mountainous territory.

The appellant's railway is known as a "coal road," eighty per cent of its total traffic being in that commodity.

The appellant's extensive railway lines lie partly in "Official territory" and partly in "Southern territory." North Carolina lies solely in "Southern territory." The line dividing "Official" from "Southern" territory lies along the Norfolk and Western Railroad from Bristol, Tenn., to the coast, the main line being in "Official" territory.

The evidence discloses that freight rates and transportation charges in Southern territory are notoriously higher than they are in Official territory; that this is not a matter of nominal freight rates or "commodity" rates printed in a tariff, under which there is no movement, but a matter of actual applied transportation charges under which commodities are moved, resulting in revenue.

While eighty per cent of the Company's total traffic is coal, taking, of course, a low freight charge, only forty per cent of its traffic into and out of North Carolina is coal, the rest consisting of commodities which take a much higher transportation charge; and much of it from Durham and Winston-Salem is in the high brackets. Moreover, coal shipped into North Carolina over appellant's roads is in much higher rate than Official territory.

Coal, which as stated constitutes eighty per cent of the Railroad Company's traffic in the "Northern" or "Official" territory (with which the company has attempted to set up a comparison regarding costs of transportation), moves at a commodity rate sweepingly lower than commodity rates in North Carolina. In fact, it has dropped from a low class rate to a still lower commodity rate. Especially lake cargo coal, which is hauled by the appellant company in large quantities, takes an exceptionally low rate.

The traffic, of course, is denser on the main line than upon its branches, and all things being equal, transportation under such circumstances is at comparatively less cost; but certainly not in the relative proportion of its density. The evidence discloses a condition which is so common and inevitable in such cases, to-wit, that this density of traffic is accompanied by a corresponding reduction of rates, and noticeably so in this case where the main line tracks are carrying lean traffic, that is traffic inferior in revenue-producing quality.

From an analysis of the protest filed before the Commissioner of Revenue (Record p. 22), it will appear from their gross and net earnings per mile of road in and out of North Carolina, reduced to ton mile figures, that for the North Carolina lines they hauled 88.2 tons of freight one mile to earn a dollar, while for their system outside of North Carolina they hauled 136 tons of freight one mile to earn a dollar.

In that original protest filed by the Railway against the assessment of the tax, it was shown that while the traffic density of its system is seven and a half times greater than on its North Carolina lines, its system revenue is only five times greater than for its North Carolina lines. (See Record pp. 23-25.) When seven and a half times greater traffic in ton miles produces only five times greater revenue, the conclusion is inescapable that the per ton mile revenue

on its North Carolina mileage is, at least, fifty per cent higher than for its entire system.

This is in remarkable agreement with the statement of the Railway witness, Conrad, to the effect that North Carolina traffic was richer in revenue-earning capacity in the proportion of 141.7% for North Carolina traffic to 100% system traffic per ton mile. (Record p. 326.)

When Conrad's table was corrected, showing a greater revenue under the mileage prorate allocation, this disparity was advanced to 147.7%. The testimony of the witness, Roberts, pages 383 to 589, was not "an unprovable generalization." It is not feasible to copy here this entire testimony. We must refer to the pages of the record in which it may be found. (Pages 383 to 589.)

While it was not practical for the State to make a complete audit for the full three years involved, the conclusions of the witness were based upon an actual audit and accounting of waybills covering every shipment of freight, carload and less, that moved over the lines of the Norfolk and Western Railway, to or from any point on its lines in North Carolina for a period of one month. It was further based upon an accurate observation of commodities and charges which moved for the entire period of three years. The method pursued reflects with great accuracy the facts of revenue to which the witness testified, at least, with as much accuracy as is possible under the circumstances.

The conclusion of the witness, Roberts, was, therefore, not based upon theory or generalization.

The result of this meticulous check was given to the Court and shows that the gross revenues properly creditable to the lines of the Norfolk and Western Railway in this State was, at least, 159% of the revenue produced by the equal mileage prorate formula.

The State's testimony dealt with the whole level of rates in each territory, Official and Southern. Appellant, through

its witness Keeley, seeks to discredit this testimony by comparison of selected specific rates that are lower in Southern than in trunk-line territory. This method of meeting the issue should in itself be persuasive that the Roberts testimony and conclusion could not be met in any comprehensive way. Of course, some specific rates are lower in Southern territory, but the question in issue is not selected specific rates, but the average level of all rates. This testimony, based upon an examination of every shipment that moved for a reasonably representative period, is conclusive. If the facts or conclusions are wrong, the appellant had abundant time and superior facilities to demonstrate it in the same comprehensive way.

The Keeley statement of facts and conclusions therefrom are seriously misleading in another respect. He seeks to show a lower level of rates on lines in North Carolina than for its main lines by comparing divisional rates over North Carolina lines with local rates on its system lines, and with particular reference to coal, which represents a large proportion of tonnage. It is almost universal that with respect to freight traffic that moves over two or more system lines from origin to destination, each of the participating carriers, by contractural arrangement, accepts less ton-mile revenue than for a haul of equal distance when both origin and destination are on the lines of a single system. If this were not done, the full combination of local rate for each line would constitute a prohibitive rate for joint haul traffic. The same necessity for division of rates and of revenue arising from carriage is presented to the system everywhere it has a joint haul outside of North Carolina and affects its revenues there as well.

Divisional rates on coal and other traffic moving over its North Carolina lines to connections should not be compared with local rates on its system lines, but with like divisional rates to its connecting lines in trunk line territory, where a

lower level of rates generally obtains, and presumably divisional rates with participating connecting lines lower than the divisional on traffic moving over its lines in North Carolina.

It is not our intention to invite the Court to enter the field of conflicting testimony and find which contention is right or wrong. We believe that to be the function of the court below, and when the facts have been settled by that court, should not be disturbed on review here.

It may be easily understood why the appellant seeks to avoid any showing as to its rates and revenues as applied to its North Carolina business, and why it offered no proof of its revenues as to such business and attempts to maintain that evidence offered by the State was irrelevant. The very obvious reason is that the reality in this respect would be that revenues on their North Carolina branch lines were greatly in excess of a system ratio.

Illuminating discussions of the rate structures affecting North Carolina lines of this carrier may be found in the following cases before the Interstate Commerce Commission.

Board of Trade of Winston-Salem *v.* Norfolk & Western Railway Co., 16 I. C. C. 12 (1909).
Corporation Commission of North Carolina *v.* Norfolk & Western Railroad Company, 19 I. C. C. 303 (1910).
Corporation Com. of N. C. *v.* Rockfish R. R. Co., 200 I. C. C. 571 (1934).
Southern Rate Investigation, 100, I. C. C. 513 (1925) Idem, 109 I. C. C. 300 (1925) Idem, 113 I. C. C. 200 (1926). 128 I. C. C. 567 (1927).

In the case of Corporation Commission *v.* Norfolk & Western Railway Company, *supra*, on page 311, the Commission says:

"It was admitted by the Norfolk & Western at the hearing that at no point on its line were as high rates made, mileage alone considered, as are applied to Winston-Salem

and Durham from Roanoke and Lynchburg, respectively."

It clearly appears from both the cases cited that the rates approved by the Interstate Commerce Commission as affecting these points took into account the identical considerations pointed out by the carrier in the instant case, by reason of which they were permitted to maintain relatively high rates on these branch lines.

In the Southern Class Rate Investigation, *supra*, at page 520, etc., the Commission sets out the history of the Southern rate structure. The Norfolk & Western Railroad from Bristol, Tennessee, to Norfolk, Virginia, is the Northern Boundary of the Southern Territory (page 518, note 1) leaving that part of Virginia south of said line and all of North Carolina and parts of other states in the broad scope of that territory. Thus the division of the carrier in North Carolina and Virginia, south of this line are classified as being in the Carolina Division of Southern Territory.

In Board of Trade of Winston-Salem *v.* Norfolk & Western Railway Company, 16 Interstate Commerce Commission Reports, 1214, it will be seen that this defendant used precisely the argument adopted in this case—namely, the argument of lighter traffic and smaller train loads, heavier grades and sharp curves, and greater expenses of operation, to sustain rates admittedly higher than on other parts of the system.

It is interesting to note from these cases that as far back as 1909, the *net* earnings of the Winston-Salem Line alone were admitted to be on annual average $220,409.00; but that was before the income tax law became effective. The population of the town has enormously increased since then.

A good picture of the higher transportation charges in North Carolina than in Official Territory, which was referred to as "an unproved generalization" may be found from Corporation Commission of the State of North Carolina *v.* Norfolk & Western Railway Company et al., 19 Interstate Commerce Commission Reports 303, dealing with rates to

Winston-Salem and Durham. It was said "because of conditions which exist at the Virginia cities and do not exist at Winston-Salem and Durham, complainant's charge of unjust discrimination is not sustained upon this record." "Trunk line conditions have been extended to Virginia cities above described and trunk line rates are made to these points where the density of traffic characteristic of trunk line rates does not exist. The extension of the Virginia City rates to Winston-Salem and Durham would result in moving trunk line rates farther south and aggravating a situation which has given rise to much complaint."

Since that time some rates have been modified and adjusted, but the average rate level still remains as testified by the witness Roberts, "notoriously higher" in the Southern Territory in which these branches lie, than in the Northern Territory containing the rest of the vast Norfolk & Western Railway System.

In this connection we also cite as illuminating:

Danville *v.* Southern Railway Co., 18 I. C. C. Report 409;

Wilmington Tariff Association *v.* C. & P. Railway Co., 9 I. C. C. Report 118;

Charlotte Shippers Association *v.* Southern Railway, 11 I. C. C. Report 109.

Consumers Coal Co. *v.* A. & Y. Ry. Co., Dec. 11, 1935.

In all of these cases appellant was a party.

We are not complaining here of any railroad rates and we are not trying to have them changed or adjusted; we are simply citing these cases in corroboration of facts as to which there does not seem to have ever been any question or controversy except that raised in a perfunctory way by the Railway witness in the instant case.

CONCLUSION

Appellant has not carried the burden which rested upon it to show the unconstitutionality of the taxing statute as

applied to its business. In lieu of any evidence as to its actual revenues in this State, it demanded that the average revenue determined by the mere application of the statute which it is attacking, be taken as its gross operating expenses in this State. It denies the right of the Court to make any investigation of such gross income in this State other than that which the administrative statute itself determines. The adoption of such a theory of investigation in matters of this sort would definitely permit the Railroad Company to escape taxes altogether and for all time.

In the court below, the Railway Company had to prove its case, which was entirely one of fact, by competent evidence. No evidence whatsoever offered by the Railway Company was rejected. The trial was had in strict accordance with the practice of the Court and by a method or trial selected by this appellant. The findings of the court below were, we respectfully submit, sufficient. The only possible complaint which this appellant may now have is as to the procedure in the court below, and that was fair according to established practice and consonant with the requirements of due process of law, and the judgment should be permitted to stand.

The appellant has not even approached the standard required for success in cases of this sort.

Henderson Bridge Co. *v.* Henderson, 173 U. S. 592, 43 L. Ed. 823.

Clearly the case falls in a class with Underwood Typewriter Co. *v.* Chamberlain, 254 U. S. 113, 65 L. Ed. 165, and Maxwell *v.* Kent-Coffey Mfg. Co., 204 N. C. 365, 291 U. S. 642, and should be controlled thereby.

Respectfully submitted,

A. A. F. SEAWELL,
Attorney General of North Carolina.
HARRY MCMULLAN,
Assistant Attorney General of North Carolina.
I. M. BAILEY,
Counsel for Appellee.

572. By consent. Any or all of the issues in an action, whether of fact or law, may be referred, upon the written consent of the parties, except in actions to annul a marriage, or for divorce and separation. (Rev., s. 518; Code, s. 420; C. C. P., s. 244.)

573. Compulsory. Where the parties do not consent, the court may, upon the application of either, or of its own motion, direct a reference in the following cases:

1. Where the trial of an issue of fact requires the examination of a long account on either side; in which case the Referee may be directed to hear and decide the whole issue, or to report upon any specific question of fact involved therein.

2. Where the taking of an account is necessary for the information of the court, before judgment, or for carrying a judgment or order into effect.

3. Where the case involves a complicated question of boundary, or one which requires a personal view of the premises.

4. Where a question of fact other than upon the pleadings arises upon motion or otherwise, in any stage of the action.

5. Where the issues of fact and questions of fact arise in an action of which the courts of equity of the State had exclusive jurisdiction prior to the adoption of the Constitution of one thousand eight hundred and sixty-eight, and in which the matter or amount in dispute is not less than the sum or value of five hundred dollars.

The compulsory reference under this section does not deprive either party of his constitutional right to a trial by jury of the issues of fact arising on the pleadings, but such trial shall be only upon the written evidence taken before the Referee. (Rev., s. 519; Code, s. 421; 1897, c. 237, ss. 1, 2; C. C. P., s. 245; 1917, c. 280; 1919, c. 7.)

578. Report; review and judgment. The Referee shall make and deliver a report, within the time ordered by the court, to the clerk of the court in which the action is pending. Either party, during the term or upon ten days notice to the adverse party out of term, may move the judge to review the report, and set aside, modify or confirm it in whole or in part, and no judgment may be entered on any reference except by order of the judge. (Rev., s. 524; Code, s. 423; C. C. P., s. 247.)